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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

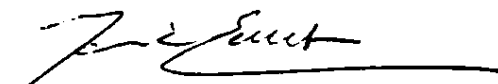
NIC #1280-83
16 February 1983

National Intelligence Council

NOTE FOR: Director of Central Intelligence
THROUGH: Chairman, National Intelligence Council
FROM: Maurice C. Ernst, NIO/Economics
SUBJECT: East-West Economic Initiatives

1. Attached are some memos I have sent to Allen Wallis, Lionel Olmer, Norman Bailey, and Richard Perle to give my personal views on the state of play on our East-West economic initiatives and what we can reasonably expect may emerge from them. There is considerable concern in the NSC and elsewhere about the slow progress on the East-West initiatives. The State Department has been managing the entire process and things are getting bogged down at the lower bureaucratic levels. Allen Wallis has just returned from a trip to Europe and presumably will be reviewing the entire business. Since the initial meeting, the steering group, which is supposed to review progress, has not met. I understand that Judge Clark was to see Secretary Shultz today to express his concern about where things are going.

2. Specifically, I believe that we should focus our efforts more strongly on achievable goals--in particular, improving COCOM controls--and avoid chasing unattainable goals, such as broad controls over oil and gas equipment. Also, we should insist on procedures for production of the NATO Study which give a reasonable chance of success.


Maurice C. Ernst

Attachments:
As stated

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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

NIC #1278-83
16 February 1983

National Intelligence Council

MEMORANDUM FOR: W. Allen Wallis, State
Norman A. Bailey, NSC
Lionel H. Olmer, Commerce
Richard Perle, Defense

FROM: Maurice C. Ernst
National Intelligence Officer for Economics

SUBJECT: East-West Economic Initiatives

Attached are some personal thoughts on how our East-West economic initiatives are doing, and what we can reasonably expect will emerge from them. I have also attached: (1) some tentative conclusions that might come out of the NATO Study; and (2) a copy of a memo I sent to Tom Niles and others expressing my concern as to what I believe is the inadequacy of the agreed procedures for producing the NATO economic paper. There is some opposition within the State Department to pushing my suggestion, but I feel strongly about the matter.


Maurice C. Ernst

Attachments:
As stated

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The State of Play on the East-West Economic Initiatives-- What We Might Expect from Our Allies

The initiatives begun by Secretary Shultz at La Sapiniere at best are likely to yield only modest progress in time for the next Economic Summit. Concrete progress is most feasible in the area of export controls because there is general Allied agreement on the desirability of limiting exports with specific military uses. The potential for instituting improvements in the COCOM system may not be realized, however, because of the US insistence on emphasizing oil and gas equipment, which is important to the Soviet economy, but has few direct military uses, in the COCOM study of "other technologies." The joint studies in NATO and OECD on the strategic implications of East-West economic relations and on energy, may help to sensitize our Allies and facilitate future policy discussions, but are unlikely to lead to any specific actions by the time of the Summit.

A major weakness of the current exchanges with our Allies on East-West economic issues is the absence of a consultative group involving the Big Seven. Major East-West issues, such as large Soviet gas projects, cannot be adequately handled in NATO, the OECD, or COCOM. Yet informal consultation on such projects is essential if major Allied frictions, such as those that developed over the Siberian gas pipeline, are to be avoided. We and the Allies have a common interest in doing what we can to avoid Soviet manipulation of our mutual political and economic issues and differences. Perhaps the Summit principals could agree on the formation of such an informal steering group in the future.

NATO Economic Study

The study of the implications of East-West economic relations for the Alliance is under way. The main problems appear to be bureaucratic: The low competence of the NATO Economic Staff; the parochialism of the NATO Economic Committee, which is unused to dealing with important topics; and the general tendency to compromise in order to avoid controversy. If the Study is going to be of any use, it must be brief and focused on the right issues, rather than long, encyclopedic, and largely irrelevant as has been the common pattern. The attached draft conclusions are, I believe, valid, defensible, and, in some form, saleable to our Allies. A thorough review of the entire paper at the senior analytical (non-policy) level is essential (see attachment). If early progress seems inadequate, we must be prepared to raise issues to higher levels.

OECD/IEA Energy Studies

This is the initiative which substantively is in the best shape. The IEA has done a great deal of work on energy markets, including natural gas, and is addressing most of the issues the US is concerned about. The study will:

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- o Assess the vulnerability of European gas consumers to supply interruptions, including from the USSR.
- o Show the potential growth in West European imports of Soviet gas in the 1990s and beyond--
- o Discuss alternative sources, including Norway.

However, the study is unlikely to make any concrete suggestions on steps--technical, economic, or political--that would be necessary to help bring Norwegian gas on stream. It will, therefore, be only a first step in the US effort to achieve this result; the harder part will come later.

OECD Work on East-West Trade and Finance

The OECD seems to be moving ahead to upgrade its effort to collect and analyze information on East-West trade and finance, including more frequent and comprehensive reporting of credits and debt. If this effort proves successful, NATO can make use of the same data for its purposes. On the whole, OECD analysis of East-West economic relations has been of high quality.

Little if anything, however, is likely to come out of the OECD that might provide a basis for additional restrictions on Western trade with the East. Declines in market interest rates have largely eliminated interest subsidies. What subsidies are provided on exports to the Eastern Bloc are considered by our Allies as non-discriminatory--for example, in the case of agricultural exports--and consequently as not falling under the agreement in the "non-paper."

The issue of whether the Soviet foreign trade monopoly has given Moscow undue gains from trade has been raised on many occasions, but with few useful results. Although Moscow's foreign traders are quick to take advantage of market conditions, there is little evidence that they have acted as monopolists or monopsonists. This reflects not only relatively small Soviet market shares for most goods, but also the fact that Soviet foreign traders have no control over Soviet production or domestic demand.

Other High Technology, Including Oil and Gas

The objective of this initiative, which is to be lodged in COCOM, has been unclear from the start. The basic problem is that it mixes two very different problems in a COCOM framework: (1) improvements in the selection of new technologies to be controlled and perhaps procedures for COCOM control; and (2) the special importance of Western oil and gas equipment and technology in the development of Soviet energy production and exports. The general principles agreed upon in the "non-paper" and reiterated by our Allies are entirely consistent with the first

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objective. But there appears to be no basis for agreement on the desirability of restricting exports of oil and gas equipment, except those few which have specific military applications, because the Allies do not regard the growth of the Soviet economy or of Soviet hard currency earnings to be undesirable as such.

In the view of some COCOM experts, present COCOM policies and procedures are inadequate in several respects:

- o The COCOM control lists cover very little in the way of disembodied technology--they concentrate on physical equipment. Such technology, however, can be extremely important to the Soviet military.
- o The only occasion in COCOM for bringing Allied technical expertise systematically to bear on export control issues comes during the list reviews, which takes place every three years. Such a review is now in progress and is going fairly well. In between list review, countries may suggest additions to the lists, but there is rarely a satisfactory technical exchange. In view of the rapid pace of technology development today, the technical review process needs to be done on a continuous basis.
- o COCOM deals with products and technologies which have clearly identifiable military uses. DOD is properly concerned about emerging technologies which do not yet, but probably will, have major military application. Furthermore, the most advanced technologies being developed in the West today are for commercial, not military, purposes. Later, perhaps as much as three to five years later, these advanced civilian technologies are being applied to new military weapons systems. These too need to be controlled in some fashion.

Proposals such as these are likely to find some support among our Allies. For example, the Germans have recently proposed that a fourth COCOM list--for disembodied technologies--be established. The French also claim to be strongly behind the effort to improve COCOM, and may have some creative ideas.

Unfortunately, US insistence on COCOM treatment of oil and gas equipment and technology may get in the way of progress along these lines. Unless the effort to improve COCOM (in addition to the present list review) is more clearly thought out and better focused, we may miss a major opportunity to make some concrete progress before the Economic Summit.

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